

Message Text

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PAGE 01 MADRID 08134 01 OF 03 171722Z
ACTION EUR-12

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INFO AMEMBASSY LISBON
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DEPT OF TREASURY WASHDC
USDOC WASHDC

UNCLAS SECTION 01 OF 03 MADRID 08134

USOECN, USEEC

TREASURY PLS PASS FEDERAL RESERVE AND EXPORT-IMPORT BANK

E.O. 11652 N/A
TAGS: EFIN, SP
SUBJECT: OPERATING FRAMEWORK FOR FOREIGN BANKS
REF: MADRID 6874

1. SUMMARY: THE DECREE AUTHORIZING FOREIGN BANK OPERATIONS
IN SPAIN WENT INTO EFFECT ON JUNE 24, (TEXT AND TRANS-
LATION SENT BY AIRGRAM.) THE DECREE PROVIDES A SET OF
OVERALL GUIDELINES. DETAILED PROCEDURAL STEPS WILL HAVE
TO BE WORKED OUT BY THE BANK OF SPAIN. MANY POLICY AND
OPERATIONAL QUESTIONS REMAIN UNANSWERED.

- AS OUTLINED IN THE REFERENCED TELEGRAM, FOREIGN BANKS
WILL BE ALLOWED TO OPEN UP TO THREE BRANCHES EACH.
REQUIRED CAPITAL IS 750 MILLION PESETAS (ABOUT \$9.7
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PAGE 02 MADRID 08134 01 OF 03 171722Z

MILLION.) WHOLLY OWNED SUBSIDIARIES OF FOREIGN BANKS
ARE ALLOWED BUT THE CAPITAL REQUIREMENTS ARE DOUBLE
(1.5 BILLION PESETAS.) LOCAL CURRENCY ACTIVITY IS
LIMITED TO 40 PERCENT OF THE OVERALL LOAN PORTFOLIO
PLUS GOVERNMENT SECURITIES AND REQUIRED RESERVES.
FOREIGN BANKS WILL NOT BE ALLOWED TO OWN OR TRADE LISTED
STOCKS OF SPANISH COMPANIES. THEY WILL BE ABLE TO SEEK

FINANCING IN THE INTERBANK MARKET. PROFIT AND DIVIDEND REPARTITION RULES WILL BE THE SAME AS THOSE APPLIED TO OTHER FOREIGN INVESTORS AND LOCAL BANKS, I.E., RATHER RESTRICTIVE BUT MANAGEABLE. APPROXIMATELY 10 FOREIGN BRANCHES ARE EXPECTED TO BE APPROVED BY THE END OF THIS YEAR WITH 3 TO 4 AMERICAN BANKS INCLUDED.
END SUMMARY

2. FRAMEWORK AND ANALYSIS: THREE TYPES OF FOREIGN BANKING ACTIVITIES ARE ALLOWED: REPRESENTATIVE OFFICES, BRANCHES AND WHOLLY OWNED SUBSIDIARIES.

3. REPRESENTATIVE OFFICES ARE ALLOWED UNDER THE DECREE TO CARRY OUT ONLY "INFORMATIONAL ACTIVITIES" THEY ARE NOT PERMITTED TO ENGAGE IN "CREDIT, DEPOSIT OR FINANCIAL INTERMEDIATION OPERATIONS."

- COMMENT: 48 FOREIGN BANKS HAVE ESTABLISHED REPRESENTATIVE OFFICES IN SPAIN OVER THE YEARS. THEY ARE ENGAGED IN EVERYTHING FROM BOOKING LARGE OFFSHORE LOANS FOR MULTINATIONAL AND SPANISH BORROWERS TO NEGOTIATING DIRECT AND SYNDICATED LOANS TO THE GOVERNMENT, SUPERVISING FINANCE AND LEASING COMPANIES, ETC. SINCE PROBABLY NO MORE THAN HALF WILL SEEK TO OPEN BRANCHES (AND NOT ALL OF THOSE WILL BE GIVEN PERMISSION IN THE FIRST YEAR) THERE ARE QUESTIONS AS TO WHETHER THE NEW DECREE WILL CURTAIL
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PAGE 03 MADRID 08134 01 OF 03 171722Z

THEIR GENERALLY FREEWHEELING ACTIVITIES. THE ANSWER OF COURSE WILL DEPEND ON HOW STRICTLY THE BANK OF SPAIN CHOOSES TO INTERPRET THE LANGUAGE OF THE DECREE. GIVEN THE COUNTRIES' CONTINUED NEED FOR ACCESS TO FOREIGN CAPITAL WE DO NOT ANTICIPATE ANY SIGNIFICANT TIGHTENING OF CONTROL OVER REPRESENTATIVE OFFICE ACTIVITIES.

4. WHOLLY OWNED SUBSIDIARIES MUST HAVE PAID-IN CAPITAL OF 750 MILLION PESETAS PLUS A FULLY SUBSCRIBED EQUITY ISSUE EQUAL TO 100 OF CAPITAL. OWNERSHIP SHARES CANNOT BE SOLD, PLEDGED OR ENCUMBERED IN ANY WAY WITHOUT THE EXPRESS PERMISSION OF THE BANK OF SPAIN. THE SAME PROHIBITION APPLIES TO ANY NEW SHARES ISSUED AS A RESULT OF AN INCREASE IN CAPITAL. DIVIDEND RULES WILL BE THE SAME AS THOSE APPLIED TO SPANISH BANKS, THAT IS A MAXIMUM OF 6 PERCENT OF CAPITAL PLUS RESERVES PER YEAR CAN BE DISTRIBUTED TO SHAREHOLDERS. ANY ADDITIONAL PROFITS MUST BE REINVESTED AS ADDITIONS TO CAPITAL.

- COMMENT: THIS PARTICULAR RESTRICTION ON DIVIDEND DISTRIBUTION HAS BEEN A SORE POINT WITH SPANISH BANKERS FOR ALMOST 40 YEARS. THERE IS CONSTANT PRESSURE TO CHANGE

IT, BUT WITH LITTLE PROSPECT OF SUCCESS. SPANISH BANKS
ARE GENERALLY ABLE TO GET AROUND THE RESTRICTIONS BECAUSE
OF THEIR INTERLOCKING RELATIONSHIP WITH INDUSTRY. THEY
SIMPLY PASS ON PROFITS TO THEIR INDUSTRIAL SUBSIDIARIES
IN THE FORM OF VERY LOW COST FINANCING. FOREIGN BANK,
PROHIBITED FROM TAKING ANY EQUITY POSITION IN SPANISH

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PAGE 01 MADRID 08134 02 OF 03 180203Z
ACTION EUR-12

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INR-10 NSAE-00 SP-02 STR-07 LAB-04 SIL-01 OMB-01
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UNCLAS SECTION 02 OF 03 MADRID 08134

(C O R R E C T E D C O P Y-DEPT OF TREASURY ADDEE CORRECTED)

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BUSINESS FIRMS WILL NOT BE ABLE TO DO THIS.

5. BRANCHES OF FOREIGN BANKS MUST HAVE A PAID IN CAPITAL
OF 750 MILLION PESETAS. TRANSFERS TO THE PARENT COMPANY
WITHIN EACH FISCAL YEAR ARE LIMITED TO THE SAME AMOUNTS
THAT SPANISH BANKS CAN PAY IN DIVIDENDS, THAT IS 6 OF
CAPITAL PLUS RESERVES. SINCE THESE TRANSFERS ARE BROADLY
DEFINED IN THE DECREE TO INCLUDE (IN ADDITION TO PROFITS)
SUCH THINGS AS "PARTICIPATION IN GENERAL EXPENSES" THERE
OBVIOUSLY WILL HAVE TO BE A CONSIDERABLE AMOUNT OF
"INTERPRETATION" BY THE BANK OF SPAIN TO ESTABLISH A
REASONABLE BASIS FOR PROFITABILITY.

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PAGE 02 MADRID 08134 02 OF 03 180203Z

6. OPERATIONS: BRANCHES AND WHOLLY OWNED SUBSIDIARIES CAN OWN CREDIT CARD COMPANIES, DATA PROCESSING SERVICES FOR THE BANK ITSELF AND "OTHER AUXILIARY SERVICES OF THE BANKING FUNCTION." DEPENDING ON HOW LIBERALLY THE BANK OF SPAIN CHOOSES TO INTERPRET THIS PROVISION FOREIGN BANKS MAY BE ABLE TO ENTER A WIDE VARIETY OF BROKERAGE, MONEY MANAGEMENT, LEASING, SOFTWARE, ETC. FIELDS THAT ARE JUST STARTING UP HERE AND HAVE EXCELLENT GROWTH POTENTIAL.

7. FUNDING: THE SPANISH AUTHORITIES WOULD OBVIOUSLY LIKE TO SEE THE FOREIGN BANKS BRING THEIR OWN FUNDS INTO THE COUNTRY TO AS GREAT AN EXTENT AS POSSIBLE. THE 40PCT LIMITATION ON LOCAL FINANCING IS DESIGNED TO FORCE THE BANKS TO SUPPLY THE BULK OF THEIR OWN FUNDING FROM THE EURO CURRENCY MARKET; AS WELL AS TO SHELTER THE DOMESTIC BUSINESS OF SPANISH BANKS. IN AN EARLIER DRAFT VERSION OF THE LAW THE LIMITATION WAS 25PCT, BUT FOREIGN BANKS COMPLAINED ABOUT BEING TOTALLY SHUT OUT OF THE LOCAL MARKET (EVEN 40PCT DOES NOT LEAVE THEM WITH MUCH OPERATING ROOM) AND THE AUTHORITIES EASED UP A BIT.

8. FOREIGN BANKS WILL ALSO HAVE ACCESS TO THE INTERBANK MARKET AS A SOURCE OF FUNDING. BUT THIS IS NOT EXPECTED TO INCREASE THE AVAILABILITY OF READILY LOANABLE FUNDS IN ANY MAJOR WAY. IT IS BASICALLY A FAIRLY SMALL MARKET AND THE LARGER SPANISH BANKS ARE IN A POSITION TO PRETTY WELL CONTROL ACCESS TO IT. ALSO, THEY HAVE MADE IT CLEAR THAT THEY WOULD NOT BE HAPPY TO SEE THE FOREIGN BANKS COME TOO AGGRESSIVELY INTO TRYING TO USE THE MARKET AS A REGULAR SOURCE OF FUNDING. IN ADDITION RATES IN THE MARKET HAVE BEEN EXTREMELY VOLATILE LATELY (FROM 24PCT DOWN TO 3PCT AND BACK UP TO 22PCT OVER THE LAST 7 MONTHS THUS MAKING IT

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PAGE 03 MADRID 08134 02 OF 03 180203Z

POOR SOURCE OF STEADY FINANCING.

9. WE EXPECT THE GOVERNMENT TO APPROVE SOME 8-10 FOREIGN BANK BRANCHES THIS YEAR, WITH THE FIRST TO BE OPERATING BY AROUND SEPTEMBER. THE BANK OF SPAIN WILL SPREAD THE APPROVALS OUT TO THOSE BANKS THAT HAVE HISTORICALLY BEEN BIG LENDERS TO SPAIN, AND THAT REPRESENT SPAIN'S MAJOR TRADING PARTNERS. BANKS FROM WEST GERMANY, THE UNITED

KINGDOM, FRANCE, JAPAN, THE UNITED STATES AND PERHAPS SWITZERLAND SHOULD BE IN THE FIRST ROUND OF APPROVALS. CHASE MANHATTAN, FIRST NATIONAL CITY, MANUFACTURERS HANOVER, MORGAN GUARANTY, FIRST NATIONAL OF CHICAGO AND PERHAPS A FEW MORE U.S. BANKS ARE ASKING FOR APPROVAL TO OPEN A BRANCH. WE WOULD EXPECT 3, OR AT THE MOST 4, TO GET IT THIS YEAR. BANK OF AMERICA ALREADY HAS A 50PCT SHARE IN A SPANISH BANK AND THUS WILL PROBABLY OPT FOR THE WHOLLY-OWNED SUBSIDIARY ROUTE.

10. PRESSURE FOR RECIPROCITY FROM FOREIGN GOVERNMENTS WHO ALLOW SPANISH BANKS TO OPERATE IN THEIR TERRITORY WAS ONE REASON FOR PASSAGE OF THIS LAW. ANOTHER, AND MORE SIGNIFICANT FACTOR IS THAT THE GOVERNMENT (AS WELL AS MOST INTERESTED OBSERVORS) FULLY RECOGNIZES THAT SPANISH BANKING IS AN OLIGOPOLISTIC AND INSUFFICIENTLY REGULATED INDUSTRY THAT DOES NOT SERVE TO ALLOCATE SCARCE RESOURCES IN THE MOST EFFICIENT MANNER. IT IS COMMONLY BELIEVED HERE THAT THE BANKING INDUSTRY OWNS OUTRIGHT OR DIRECTLY CONTROLS SOME 40PCT OF THE LARGER INDUSTRIAL ORGANIZATIONS. THEIR LENDING IS OF COURSE CONCENTRATED HERE. EXTREELY HIGH MARGINS (BY U.S. STANDARDS) ARE DEMANDED FOR OTHER LENDING, AND THE BANKS HAVE BEEN SLOW TO DEVELOP THE SMALL BUSINESS ORIENTATED SERVICES THAT GIVE A LARGER SHARE OF THE POPULATION ACCESS TO CAPITAL MARKETS. THE GOVERNMENT BELIEVES THAT FOREIGN BANKS WILL BE MORE AGGRESSIVE AND MORE INNOVATIVE IN SERVICING THE LOCAL MARKET. IT IS NOT EXPECTED THAT FOREIGN BANKS WILL DRAIN ANY

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PAGE 04 MADRID 08134 02 OF 03 180203Z

SIGNIFICANT AMOUNT OF BUSINESS AWAY FORM SPANISH BANKS. RATHER, THEY ARE HOPING FOR THE GENERAL UPGRADING OF ALL

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PAGE 01 MADRID 08134 03 OF 03 171745Z
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FM AMEMBASSY MADRID

TO SECSTATE WASHDC 5380

INFO AMEMBASSY LISBON

AMEMBASSY PARIS

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UNCLAS SECTION 03 OF 03 MADRID 08134

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BANKING SERVICES THAT SHOULD COME WITH INCREASED COMPE-
TITION.TODMAN

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TAGS: EFIN, SP
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